CLAIMS AGAINST TRUSTEES FOLLOWING PITT v HOLT

INTRODUCTION

In this talk I want to explore the recent English Court of Appeal decision in a conjoined appeal in two cases: Pitt v Holt and Futter v Futter [2011] 3 WLR 19 in a context where a mistake has been made as to the tax consequences of a transaction.

Both cases involved a reconsideration of the so-called "rule in Hastings-Bass" (based on dicta in Re Hastings-Bass [1975] Ch 25) that the court will interfere with the exercise of a discretion by trustees where it is clear that the trustees would not have acted as they did:

(a) had they not failed to take into account considerations which they ought to have taken into account or
(b) taken into account considerations which they ought not to have taken into account.

The claim was that the trustees (Futter) or a fiduciary (Pitt) had exercised powers in a way that gave rise to unforeseen tax liabilities, and that they would not have so acted if they had taken the true tax position into account. The claims failed, in the Court of Appeal, because the exercise of a discretion by trustees, which is within the terms of the relevant power, cannot be set aside unless the trustees have committed a breach of trust. There can be no breach of trust if (as was the case) the trustees or fiduciary had taken and acted upon appropriate tax advice, even if that advice proved to be wrong.

The decision, if followed in Jersey, may have an impact on claims against trustees.

FACTS OF FUTTER v FUTTER

Futter v Futter involved two offshore discretionary trusts containing the following powers:

(a) a power of enlargement (to enlarge the interest of a life tenant to an absolute interest in capital) and

(b) a power of advancement (to advance capital to remainder beneficiaries).

The trustees exercised these powers to transfer capital to beneficiaries in the U.K. There were "stockpiled gains" in the trust. The transfer of assets onshore gave rise to a CGT liability in respect of those gains.

However, the trustees mistakenly believed that the recipient beneficiaries could set off their personal losses against the gains. One of the trustees was a solicitor, and his firm wrongly advised the trustees that personal losses could be set off.

The trustees brought proceedings seeking declarations that the enlargement and advancement were void, or that they were voidable and should be set aside, on the basis that they had made a mistake as to the CGT consequences of their dispositions, and that they would not have made the dispositions that they did, had they taken into account the true tax position. The trustees succeeded at first instance.

FACTS OF PITT v HOLT

Mrs Pitt was the receiver, appointed by the Court of Protection, for her husband, Mr Pitt, who had been injured in a road accident. She received a lump sum and annuity under the compromise of a damages claim. Exercising her fiduciary powers as receiver, she settled the lump sum and annuity on discretionary trusts for the benefit of Mr Pitt and his family.

Mrs Pitt received general tax advice that there were no adverse tax consequences. However, no consideration was given to IHT. In fact, the settlement on discretionary trusts was a chargeable transfer, giving rise to an immediate IHT liability of £100,000. The trust would also suffer 10-year and exit charges. Such liabilities could have been avoided by a settlement on a disabled person's trust.

Mrs Pitt applied to set aside the settlement on the basis of the rule in Hastings-Bass. She was a fiduciary in the same position as a trustee exercising a discretionary power. She claimed that, if she had appreciated that a transfer into a discretionary trust gave rise to a substantial IHT liability, she would not have entered into the settlement. She succeeded at first instance.

COURT OF APPEAL DECISION

The Court of Appeal declined to set aside the relevant dispositions, despite their unfortunate and unanticipated tax consequences. The analysis is as follows:

(1) A crucial distinction must be drawn between the exercise of powers that are void, rather than voidable. The exercise of a power will be void if it is outside the scope of the power because of:

   a. a procedural defect, e.g. a failure to obtain a necessary consent, or where the power must be exercised by deed, but is not;

   b. a substantive defect, e.g. an unauthorised delegation, or appointment to a non-beneficiary; or

   c. a legal defect, e.g. an appointment infringing the rule against perpetuities.

(2) Pitt and Futter were not cases where the trustees/fiduciary had exceeded the scope of their powers. In order to set aside the exercise of a discretion, within the scope of the powers of the trustees, it was necessary to establish that the trustees had exercised their powers in breach of trust. If so, the exercise of the power would be voidable at the instance of a beneficiary.

(3) Trustees are under a duty to take into account relevant matters, and not to take into account irrelevant matters. Where tax matters are relevant, the duty of the trustees, pursuant to their duty to take care and skill, will be to take proper tax advice. However, if they take tax advice from appropriate and reputable advisers, the trustees will have discharged that duty. That is so even if the tax advice turns out to be wrong; and even though they could be said to have failed to take into account a relevant matter.

(4) In Pitt and Futter tax advice had been taken. It may have been wrong, or incomplete. However, there was no breach of trust. Therefore, the dispositions stood.

CLAIMS AGAINST TRUSTEES

It follows that, in future, there may still be a claim to set aside the exercise of a discretionary power by trustees if the trustee has failed to take into account a relevant consideration (such as tax) or taken into account an irrelevant consideration, where the trustee has acted in breach of trust.

The classic case would be where the trustees have failed to appreciate the tax consequences of their disposition, having neglected to take any tax advice at all. Strangely, it may be easier for a trustee to set aside a disposition and to avoid a tax liability if he has acted in breach of trust, than where he has not. This should not, however, be an incentive to trustees to neglect to take tax advice.

The proper claimants would be the beneficiaries of the trust, alleging a breach of trust. They would bring a breach of trust claim in the usual way, claiming that the exercise of the trustees' discretion be set aside on the grounds of breach of trust. There may be an alternative claim for compensation for breach of trust. However, in many cases, the trustees will be protected from liability unless they have acted fraudulently. The trustees might, therefore, not oppose the claim to set aside the disposition.

There may, however, be a defence to the claim if the beneficiary has acquiesced in the breach of trust, or if third party rights have intervened.

It might be proper for the trustees to commence proceedings where they are seeking the directions of the Court when a beneficiary has alleged breach, but delayed in commencing proceedings.

However, the previous practice of trustees applying to the Court to set aside their own dispositions, confessing to a (tax) mistake, but not admitting a breach of trust, is no longer good practice in England and Wales.

CLAIMS AGAINST PROFESSIONAL ADVISERS

Where the trustees have validly exercised a power, acting on negligent tax advice, which causes loss to the trust fund, it will not be possible for the trustees, or the beneficiaries, to obtain an order setting aside the exercise of the power.

However, the trustees might sue their professional advisers in negligence in respect of any loss to the trust fund. The beneficiaries themselves may also have a claim in respect of any losses suffered by them.

The remedy of trustees, who have acted on negligent tax advice, will, therefore, be to bring a professional negligence claim against the professional advisers; not to apply to the court to have the disposition set aside.

APPEAL

On 1 August 2011 the Supreme Court gave permission to appeal both decisions.

It seems to me to be unlikely that the Supreme Court will overturn the decision of the Court of Appeal. It makes sense that a disposition by trustees, within their powers, should only be open to challenge if the trustees have acted in breach of trust, and that there is no breach of trust if apparently competent, professional advice is taken.

Furthermore, in England and Wales, a voluntary disposition by an individual cannot be set aside if it gives rise to unforeseen tax consequences. Arguably, a disposition by a trustee simply because the trustees have not appreciated the true tax consequences.

There is also a policy consideration that tax advisers should not be able to wriggle out of liability for negligent decisions.

HASTINGS-BASS IN JERSEY

The Hastings-Bass principle has been applied in Jersey. In Green GLG Trust (Green GLG) [2002] JLR 571 a Jersey trustee made appointments of capital which gave rise to an unanticipated GGT liability on the settlor, who had a right of recovery against the trustee. The trustee and the settlor applied to the Jersey court to have the appointments set aside, on the basis that, if the tax consequences had been appreciated, the appointment would not have been made. The application succeeded.

The Deputy Bailiff concluded that the principle in Hastings-Bass was entirely consistent with Jersey precedent and principle. He set aside the appointments on the basis that the trustee had a duty to consider the tax consequences, and that the trustee would have acted differently if he had known those consequences.

In Leumi v Howe (In the matter of the Howe Family No. 1 Trust) [2007] JLR 660 it was held that it was not necessary for the Court to find that the trustees had been at fault or in breach of duty, following the English first instance decision of Sieff v Fox [2005] 1 WLR 3811. However, in the light of the Court of Appeal's decision in Pitt v Holt, Sieff v Fox is wrong in this respect, as a matter of English law.

It has been held that there is no difference between a case where trustees have taken tax advice, and one where they have not (Seaton Trustees Ltd v Morgan [2007] JRC 206).

The Jersey courts have left open the question of whether it is necessary to prove that the trustees "would" or "might" have acted differently if they had known the true facts. In England, it has been suggested (Sieff v Fox) that:

(a) "would" is the test in the case of a fiduciary power, where the trustees are not bound to exercise their discretion; and

(b) "might" is the test in the case of a trust power, where the beneficiaries can require the trustees to exercise their discretion again on the correct basis.

It remains to be seen whether the Jersey courts will apply Pitt v Holt, particularly if the Court of Appeal's decision is upheld by the Supreme Court. On the one hand, the Jersey courts have been guided by English decisions prior to Pitt v Holt. On the other hand, it is more attractive to a potential settlor of a Jersey trust if dispositions by trustees giving rise to unforeseen tax consequences can be set aside; rather than the tax being paid, followed by a potential claim by the beneficiaries against the trustees, and/or by the trustees against their legal advisers, alleging fault. This may be a consideration given the commercial importance of the trust industry to Jersey.

EXPRESS CLAUSES

It may be sensible to consider the incorporation of a clause in the trust deed to the effect that the exercise of the trustees' powers is conditional upon them taking into account the true tax consequences thereof, provided that the trustees are protected by an exemption clause absolving them from liability otherwise than in the case of fraud, wilful misconduct or gross negligence. If the trustees act on wrong tax advice in exercising a discretion, they may then claim that the exercise of that discretion is void.

MISTAKE AND VOLUNTARY TRANSACTIONS

Where a settlor settles property upon trust, giving rise to unforeseen tax consequences, it will not normally be possible, in England, to set aside the transfer into trust. In Pitt v Holt there were two claims: a Hastings-Bass claim on the basis that Mrs Pitt was a fiduciary, and an alternative claim that Mrs Pitt was an individual acting under a mistake as to the tax effect of the transfer into the trust. In relation to the mistake claim, Pitt v Holt establishes three requirements:

(a) a mistake;

(b) which is sufficiently serious that the donor would not have entered into the transaction, but for the mistake; and

(c) as to the effect of the transaction itself, or as to an existing fact which is basic to the transaction, and not merely as to its consequences or the advantages to be gained by entering into it.

There is a mistake as to "effect" where a settlor settles property subject to the provisions of a trust which have a different legal effect from that which the settlor intended.

There is a mistake as to an existing fact where a settlor makes a PET into a trust, in the hope that it will be exempt upon his survival for 7 years, at a time when he was unaware that he was suffering from terminal cancer (Ogden v Griffiths Trustees [2009] Ch 162).

In Pitt v Holt the Court of Appeal held that Mrs Pitt she was acting under a mistake, which was sufficiently serious, but that the mistake was as to the tax consequences of the transaction, and not as to its legal effect. The mistake was not as to the legal effect of the transaction: Mrs Pitt intended to set up a discretionary trust. The mistake was as to the tax consequences of transferring property to a discretionary trust. A mistake as to consequences is outside the jurisdiction to set aside for mistake. Nor is the mistake one as to an existing fact, but of law.

The Court of Appeal criticised decisions of foreign courts (such as Jersey courts) which ignore the distinction between "effect" and "consequences" as being too relaxed for a donor who seeks to recover his gift.

This decision is under appeal to the Supreme Court.

JERSEY AND MISTAKE

The Jersey courts have adopted a different approach. The distinction between "effect" and "consequences" has been rejected. It is sufficient (Re the A Trust [2009] JLR 447) that:

(a) there is a mistake;

(b) the settlor/donor would not have entered into the transaction but for the mistake; and

(c) the mistake was of so serious a character as to render it unjust on the part of the donee to retain the property.

This test was affirmed in Re S Trust [2011] JRC 117 where the Court of Appeal's judgment in Pitt v Holt on mistake was considered, but not followed. In Re S Trust a donor, who was resident and domiciled in England, gave shares to a Jersey resident trustee company, who some years later transferred the shares to several US trusts. The gift to the Jersey trust gave rise to a substantial IHT charge (contrary to advice that the donor received). The donor had also not been advised that the principal beneficiaries, as US residents, could be liable to tax on distributions from the trust up to 100% of the value of any distribution. The donor applied to set aside the gift to the trust, and the transfer to the US trusts, on the grounds that she had acted under a mistake and that, but for the mistake, she would not have made the gift into the Jersey trust.

The claim succeeded. The Jersey court applied the test set out above. It saw no reason to adopt a judicial policy which favours the position of the tax authority to the prejudice of the individual citizen. It rejected the criticism that the test was too relaxed. The mistake had to be sufficiently serious that the donor would not otherwise have made the gift, and such as to render it unjust on the part of the donee to retain the property.

The Jersey court's decision allows the court to exercise a discretion on equitable grounds to set aside transactions, which it would be unjust to uphold, balancing competing interests. In Re S Trust the potential tax liability was 100% of the value of the trust, which would wholly frustrate the donor's intention to benefit the beneficiaries. None of the beneficiaries objected to the application. It would be unjust for the trustees to retain the gift. If the test is satisfied, the gift is voidable and so can be affirmed by the donor.

It is suggested that the Jersey court have got this right, and that this may be reflected in the Supreme Court's decision in Pitt v Holt. The Supreme Court may apply the test in Re the A Trust to gifts by individuals made under a serious mistake, and giving rise to unjust consequences if upheld. Indeed, it could apply the same test to the exercise of discretions by trustees to set aside dispositions, even where the trustees have not been in breach of trust because they have taken erroneous tax advice.

Jersey law applied to the transfer into the trust as the enrichment of the donee occurred in Jersey. A gift to a Jersey resident trustee (as opposed to an English trustee) may, therefore, have this to recommend it: it is easier to set aside if it gives rise to unforeseen tax consequences.